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2018 Winter Alert

On December 20, 2017, Congress passed the Tax Cuts and Jobs Act¹, which was signed into law by the President on December 22, 2017. While the new law maintains the overall framework of the existing federal estate, gift and generation-skipping transfer (GST) tax laws, it puts in place important temporary taxpayer friendly changes.

Summary

Building on the major modifications enacted under the Taxpayer Relief Act of 2012, the new Act effects further dramatic reductions in federal transfer tax burdens. Effective January 1, 2018, the law provides for the following:

- **Increased Exemptions.** The estate, gift and GST exemptions have been doubled from \$5 million to \$10 million per person, as indexed for inflation occurring after 2011. Accordingly, the inflation adjusted exemption, which would have been \$5.6 million in 2018, is expected to jump to \$11.2 million per person as of January 1, 2018.
- **Sunset.** The new law includes a “sunset” provision, pursuant to which the increased exemptions expire at the end of 2025, returning to the \$5 million level, indexed for inflation. The law also directs that regulations be prescribed to avoid a “clawback” if gifts exceed the exemption threshold when death occurs after the sunset of the exemptions.
- **Inflation Adjustment.** The inflation adjustment index has been changed. Prior law based the computation on the Consumer Price Index for all Urban Consumers (“CPI-U”). Under the new law, the adjustment will be based on Chained CPI-U (“C-CPI-U”), which generally produces a slower growing CPI calculation than the CPI-U calculation.

Planning Considerations Under the Tax Cuts and Jobs Act

- **Dramatic Window of Opportunity.** No tax legislation is “permanent.” It is important to keep in mind that the new Act was adopted along party lines, and is subject to modification by any future Congress and administration. Moreover, as noted, the increased exemptions are set to be in place for a limited period, expiring on December 31, 2025. Therefore, planning should be implemented while the law permits, and not placed on the back burner.
- **Spousal Portability.** The spousal portability provisions, initially adopted under the 2010 Tax Relief Act, allow a surviving spouse to make an election to use the deceased spouse’s unused exemption (“DSUE”). Under the new law, at least for the next 8 years, it may therefore be possible for married couples to shelter up to \$22.4 million (indexed for inflation) from federal transfer taxes.
- **Credit Shelter Planning.** Planning with testamentary “credit shelter” or “by-pass” trusts established by the first spouse to die, to reduce the overall estate taxes payable upon the death of the second spouse, has long been a cornerstone of estate planning for married couples. While the new high federal exemption amount of \$10 million, indexed for inflation, coupled with the spousal portability provisions, render it possible for married couples to shelter from federal estate tax over \$20 million without the necessity of creating trust instruments, credit shelter planning remains an appropriate and important planning tool for numerous reasons. Caution is in order, however, for those married couples with existing Wills containing federal credit shelter formula bequests. Those formulas should be reviewed to confirm that the credit shelter bequest is not overfunded or underfunded due to the exemption amounts, leaving the surviving spouse with too little or too much in assets, and potentially generating an unwanted state estate tax upon the death of the first spouse.

¹Under the reconciliation process in which the bill was finally passed by both houses of Congress, the actual name of the act is “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.”

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- State Estate Taxes. New York, like several other states, has its own estate tax system. New York incorporates into its law many of the federal estate tax provisions, but New York's exemption and rates are different from the federal exemptions.
 - While New York has repealed its gift tax², its estate tax exemption (the "NYS Basic Exclusion Amount") is presently only \$5.25 million. Under current law, the NYS Basic Exclusion Amount is scheduled to increase on January 1, 2019 to equal the federal Exemption Amount, as indexed for inflation at that time. However, the provisions of the New York law are written such that the NYS Basic Exclusion Amount in 2019 will not match the new increased federal exemption amount of \$10 million, indexed for inflation, but rather will increase only to \$5 million, as indexed for inflation occurring after 2011, using CPI-U. Accordingly it is projected that the NYS Basic Exclusion Amount at that time will be approximately \$5.8 or \$5.9 million. Consequently, for those residing in New York (and other states with a separate and lower estate tax threshold), it may be prudent to limit a credit shelter disposition to the amount that can pass free of state estate tax.
 - New York has not adopted spousal "portability" provisions to allow a surviving spouse to use a deceased spouse's unused gift and estate tax exemption.
- Gifting. Lifetime gifting of assets, whether outright or in trust, can bring substantial transfer tax savings. For those states which, like New York, impose an estate tax but not a gift tax, gifts can result in a substantial reduction in state estate tax liability. Further, the gifting of appreciating assets provides the additional benefit of removing the post-transfer appreciation in the value of the assets from the donor's estate. Many gifting vehicles, moreover, offer discounting advantages that are absent from or less effective than those associated with testamentary transfers. In assessing the benefits of lifetime gifts, since the recipient of a gift receives the donor's income tax basis in the gifted assets – as opposed to the recipient of a testamentary transfer receiving an income tax basis as of the date of death – any proposed gift must measure the potential capital gain consequences as against potential gift and estate tax savings.
 - Dynasty Trusts. For those taxpayers who have established (or wish to establish) a Dynasty Trust, substantial gifts of \$10 million (indexed for inflation), after factoring in any prior taxable gifts, may be made to a Dynasty Trust to which GST exemption may be allocated, exempting the trust assets from further estate, gift and GST taxation for the term of the trust. Creation of the trust in a jurisdiction that has repealed or liberalized its Rule Against Perpetuities can allow the trust assets to provide for future generations without being burdened by further estate, gift or GST taxes. During the lifetime of the creator of the trust, the trust can be structured as a "grantor trust" for income tax purposes, so that the creator is taxable on any income. Such payments serve to reduce further the taxpayer's gross estate for federal estate tax purposes.
 - Spousal Lifetime Access Trusts. The Spousal Lifetime Access Trust (SLAT) can enable married couples who wish to make large lifetime gifts to descendants without a dramatic impact on their current lifestyle. With a SLAT, one spouse makes a gift to an irrevocable trust using the donor-spouse's gift tax exemption. The non-donor spouse is named as a current beneficiary, which allows the trustee to make distributions of trust funds to the beneficiary-spouse during his or her life.

The Tax Cuts and Jobs Act implements far-reaching changes to the Internal Revenue Code, including the temporary changes to the estate, gift and GST exemptions summarized in this Alert. For a limited time, this law offers a valuable opportunity to transfer significant wealth to younger generations. To assure you have a tax-efficient and updated estate plan that makes timely use of techniques appropriate for each individual's circumstances, we recommend a review of existing estate plans and related documents.

² New York law provides, however, that gifts made within 3 years of death will be included in the gross estate of a New York resident decedent, if the gift is made between April 1, 2014 and December 31, 2018 and the decedent was a New York resident at the time of the gift.

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